

ORIGINAL

LAW OFFICES

MOSS & BARNETT

A PROFESSIONAL ASSOCIATION

4800 NORWEST CENTER

90 SOUTH SEVENTH STREET

MINNEAPOLIS, MINNESOTA 55402-4129

TELEPHONE (612) 347-0300

FACSIMILE (612) 339-6686

WRITER'S DIRECT DIA. NUMBER

April 11, 1996

SUSAN C. RHODE
THOMAS M. HUGHES
NICK HAY
THOMAS A. DILLON
DEANNE M. GILBERT
CASS S. WEIL
M. CECILIA RAY
JOSEPH R. KLEIN
NANCY M. KISKIS
J. MICHAEL COLLOTON
DOUGLAS M. LAWRENCE
TIMOTHY E. WUESTENHAGEN
PAUL B. ZISLA
VINCENT J. FAHNLANDER
CHARLES E. JONES
BRIAN T. GROGAN
MICHAEL J. LUZUM

CORY LARSEN BETTENG
DANIEL P. DAMOND
KLAY C. AHRENS

OF COUNSEL
RICHARD C. JOHNSON
RETIRED
J. BRAINERD
FREMONT C. FLETCHER
VERNE W. MOSS
JAMES H. HENNESSY
STANLEY R. STASEL
HOWARD S. COX
PATRICK F. FLAHERTY

HERMAN J. RATELLE
PAUL VAN VALKENBURG
MICHAEL L. FLANAGAN
THOMAS A. KELLER III
W. SCOTT HERZOG
WAYNE A. HERGOTT
JAMES E. O'BRIEN
PAUL G. NEIMANN
EDWARD L. WINER
WILLIAM N. KOSTER
WILLIAM A. HAUG
CHARLES A. PARSONS, JR.
RICHARD J. JOHNSON
ROBERT J. LUKES
JAMES A. RUBENSTEIN
THOMAS R. SHERAN
J. MICHAEL HIRSCH

EDWARD J. BLOMME
ANN K. NEWHALL
MICHAEL J. AHERN
JEFFREY L. WATSON
THOMAS J. SHROYER
DALE M. WAGNER
DAVID P. JENDRZEJEK
CURTIS D. SMITH
DAVE F. SENER
ROBERT A. BRUNIG
LOUIS J. SPELTZ
MITCHELL H. COX
MICHAEL J. BRADLEY
PETER A. KOLLER
RICHARD J. KELBER
LAURA J. McKNIGHT
KEVIN M. BUSCH

William F. Caton
Acting Secretary
Office of the Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

VIA FEDERAL EXPRESS

APR 12 1996

FEDERAL ROOM

Re: FCC 96-93 In the Matter of Federal-State Joint Board on Universal Service Initial
Comments of the Minnesota Independent Coalition

Dear Secretary:

Enclosed herewith for filing please find an original and six (6) copies of the Initial Comments Of The Minnesota Independent Coalition In The Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45. Pursuant to Paragraph 143 of the Commission's Notice of Proposed Rulemaking ("NPRM") copies of the enclosed filing have been served on the Federal-State Joint Board in accordance with the service list. One copy has also been sent to the Commission's copy contractor, International Transcription Service, Room 640, 1990 M Street, N.W., Washington, D.C. 20036. In addition, a copy of the enclosed filing has been submitted on diskette to Ernestine Creach, Common Carrier Bureau, Accounting and Audits Division, 2000 L Street, N.W., Suite 257, Washington, D.C. 20554. The 3.5 inch diskette has been formatted in an IBM compatible form using Word Perfect 5.1 for Windows software. The diskette has been submitted in "read only" mode and has been clearly labeled in accordance with the Commission's instructions at Paragraph 144 of the NPRM.

If you should have any questions regarding the enclosures or other issues with respect to the filing submitted on behalf of the Minnesota Independent Coalition please feel free to contact the undersigned.

Very truly yours,

MOSS & BARNETT,
A Professional Association

Richard J. Johnson / B.G.
Richard J. Johnson
Brian T. Grogan

BTG/slo
26614/KJ@011.DOC
Enclosures

No. of Copies rec'd
List ABCDE

006

ORIGINAL

DOCKET FILE COPY ORIGINAL

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

APR 12 1996

FEDERAL COMMUNICATIONS COMMISSION

FCC 96-93)
In the Matter of)
Federal-State Joint Board on)
Universal Service)

CC Docket No. 96-45

**INITIAL COMMENTS OF THE MINNESOTA
INDEPENDENT COALITION**

Minnesota Independent Coalition

Richard J. Johnson
Brian T. Grogan
Moss & Barnett
4800 Norwest Center
90 South Seventh Street
Minneapolis, MN 55402-4129
(612) 347-0300

Its Attorneys

Date: April 11, 1996

TABLE OF CONTENTS

I. GOALS AND PRINCIPLES OF UNIVERSAL SERVICE SUPPORT MECHANISMS.....	2
1. The Act Reflects An Extension of the Goal Of Promoting and Preserving Universal Service.....	2
2. Universal Service Includes Both Protection For Low Income Ratepayers And Equity Between Urban And Rural Areas.....	2
3. Any Additional Principles That May Be Adopted By The Commission and Joint Board Must Not Impair The Express Congressional Priority for Universal Service Over Competition.	3
II. SPECIFIC QUESTIONS TO BE ADDRESSED.....	7
1. Selection of an Appropriate Basis for Determining Comparability of Rates Is Critical.....	7
2. Which Services Should Be Included in Universal Service Support?.....	9
3. The Method Selected to Determine the Levels of Support Must Be Reliable And Allow Fulfillment of the Essential Goals of Preserving Universal Service.....	10
4. Resale Obligations and Pricing and Deaveraging Of Local Rates are Closely Related.	20
5. Recovery of Non-Traffic Sensitive Local Loop Costs From Interstate and Interexchange Services Should Not Be Eliminated.....	21
6. Contributions to the Universal Service Support Should Be Based on Interstate Retail Revenues.	23
7. The Universal Service Fund Administrator Should Have A Proven Record of Ability To Administer Such Funding Programs.....	23
III. CONCLUSION.....	24

SUMMARY

The Telecommunications Act of 1996 ("Act") reflects Congress' intent to: 1) both preserve existing universal service and expand the service to include a new range of telecommunications services; and 2) establish policies to introduce local competition. Congress recognized that preservation of universal service may require limitations on the introduction of local competition in areas served by rural telephone companies. The Commission and Joint Board should not therefore adopt policies which would be inconsistent with Congress' express priority of preserving universal service in areas served by rural telephone companies.

Congress also recognized that universal service should both insure that the price of telephone service in rural areas remains reasonably comparable to the price in urban areas and provide protection for low-income ratepayers. Determining reasonable comparable rates in urban and rural markets must include all services in the category of protected services and include the quantities of these services that customers actually use to satisfy their telephone needs. Therefore, it should be based on the average total telephone bills paid by customers. Such an approach is fair to customers and recognizes the widely varied services that Congress sought to protect.

The appropriate level of universal service support should be determined based on the actual costs incurred to provide that service. The Census Block Group Model is completely inappropriate for rural telephone companies because it is a theoretical model based on unrealistic assumptions which will have the effect of misstating the cost of service and impairing universal service goals for small rural telephone companies and their customers. Further, as Congress provided, only a single, facilities-based carrier should receive universal service funding for areas served by rural telephone companies, unless a State commission determines that more than one

recipient is appropriate. Accordingly, any new support mechanisms for areas served by rural telephone companies should not be slanted in the direction of facilitating an approach that is very likely to lead to market distortions and injury to the goals of universal service.

Congress recognized that different issues and considerations may be present between areas served by rural telephone companies and other areas. The Commission and Joint Board should also recognize those differences and not impair the priority that Congress intends for universal service goals in areas served by rural telephone companies.

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

FCC 96-93
In the Matter of
Federal-State Joint Board on
Universal Service

)
)
)
)

CC Docket No. 96-45

**INITIAL COMMENTS OF THE MINNESOTA
INDEPENDENT COALITION**

The following Initial Comments are submitted by the Minnesota Independent Coalition, an unincorporated association of over 80 small Rural Telephone Companies, within the meaning of 47 U.S.C. § 153(47), providing telephone exchange service and exchange access service in Minnesota. Although the average size is under 3,000 access lines, collectively the members of the Minnesota Independent Coalition provide telephone exchange and exchange access service to over 200,000 access lines in Minnesota. These comments will not attempt to address all of the issues noted in the Commission's Notice of Proposed Rulemaking ("NPRM"). Rather, these comments will address certain issues of particular significance to the Minnesota Independent Coalition as those issues will affect their ability to continue to provide high quality telecommunications service in Minnesota.

I. GOALS AND PRINCIPLES OF UNIVERSAL SERVICE SUPPORT MECHANISMS.

1. The Act Reflects An Extension of the Goal Of Promoting and Preserving Universal Service.

As reflected in the NPRM, the Telecommunications Act of 1996 (the "Act") reflects Congress' intent that universal service not only be preserved, but that universal service be extended to include a new range of services. As the Commission noted at ¶ 14 of the NPRM:

Prior to the 1996 Act, the Communications Act of 1934 required that the rates for telephone services be just and reasonable, without unjust or unreasonable discrimination, but did not expressly require that the rates be affordable to the average telephone subscriber or to any designated group of subscribers. The 1996 Act makes explicit that our universal service policies should promote the affordability of quality telecommunications services. . . . We note that the Act specifically provides that telecommunications services, --not the narrow category of telephone exchange services-- be affordable.

(Emphasis added.) The instruction from Congress to expand the scope of services and to expressly make these services affordable clearly demonstrates that these goals lost no importance to Congress even in the context of the development of local competition.

2. Universal Service Includes Both Protection For Low Income Ratepayers And Equity Between Urban And Rural Areas.

It is also important to recognize that two related, but different, goals are specified in the Act. Equity between urban and rural areas is a separate goal that is not satisfied by a system geared solely to providing critical financial support for low income individuals. Section 254 (b) of the Act reads in part:

UNIVERSAL SERVICE PRINCIPLES.-The Joint Board and the Commission shall base policies for the preservation and advancement of universal service on the following principles:

* * *

(3) ACCESS IN RURAL AND HIGH COST AREAS.-Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services', that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

* * *

(Emphasis added.) To accomplish these two goals, it is necessary:

- 1) to provide support for recovery of high costs to providers of telephone service who have installed and maintained facilities to serve all potential customers as common carriers of last resort; and
- 2) to provide direct financial assistance to consumers of telephone service.

Congress recognized that it is critical that low income customers not be excluded from participation in telecommunications because of the price of service. Today there are programs in place, such as Lifeline and Link-up, that address the needs of low income individual customers. The fulfillment of policies to protect low income customers does not satisfy all objectives of the Act. Rather, Congress also recognized that it is critical that the prices of telephone service in rural areas remain reasonably comparable to the prices in urban areas. Price equity between urban and rural areas is a separate but equally important policy goal.

3. Any Additional Principles That May Be Adopted By The Commission and Joint Board Must Not Impair The Express Congressional Priority for Universal Service Over Competition.

The NPRM begins with a discussion of Goals and Principles and a request for input concerning "how each of the seven principles enunciated in Section 254(b) should influence our policies on universal service." NPRM ¶ 4. At the outset, it is critical to note that the Act sets

forth **SIX** express principles in Subsections 254(b)(1) through (6) and possible “Additional Principles,” in (7), allowing adoption of:

Such other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience and necessity and are consistent with this Act.

(Emphasis added.) It is clear that the addition of principles is not a certainty and is subject to two preconditions: 1) that any additional principle be “necessary and appropriate”; and 2) that any additional principle be “consistent with this Act.”

The need for consistency with the Act certainly requires that any additional principles adopted by the Commission and Joint Board must conform to the priorities that Congress has established in the Act. While the Commission noted that Congress intended “to provide for a pro-competitive, de-regulatory national policy framework . . . opening all markets to competition.” (See NPRM ¶¶ 8,30, and 45), Congress’ statement of this goal was set forth only in the preamble to the Conference Committee Report, not in the Act. Certainly, this broad policy objective would not justify contradiction of the express priorities set forth in specific sections of the Act.

The priority that universal service goals not be impaired to promote competition between recipients of universal service support is apparent in several provisions of the Act.

First, the Act expressly allows State commissions to name a single universal service support recipient in areas served by “rural telephone companies.” Section 102(a) of the Act, adding new Subsection 214(e)(2), reads in part:

Before designating an additional eligible telecommunications carrier for an area served by a rural telephone company, the State commission shall find that the designation is in the public interest.

The Report of the Conference Committee makes it clear that the designation of a second eligible carrier for areas served by rural telephone companies is within the discretion of the State commissions. The Report reads in part:

If the area for which a second carrier requests designation as an eligible telecommunications carrier is served by a rural telephone company, then the State commission may only designate an additional carrier as an eligible telecommunications carrier if the State commission first determines that such additional designation is in the public interest.

(Emphasis added.) Clearly, Congress did not object to the designation of only one recipient of universal service support in areas served by rural telephone companies, and did not put the prospect of competition between recipients of universal service support on an equal priority with the preservation of universal service. Indeed, Congress imposed express protections and preconditions on the designation of a second recipient.

With such a clear expression of Congressional intent, any additional goals of competitive neutrality, opening markets to competition, and minimization of regulatory involvement which the Commission has noted (See NPRM ¶¶ 8, 17, 27, 30, 33, and 45) must not be allowed to impair the Congressional priority of universal service in the areas served by rural telephone companies.

The clear priority given to universal service over potential competition in areas served by rural telephone companies is also evident in the provisions of the Act that allow States to require any competitor for an area served by a rural telephone company to become an “eligible telecommunications carrier” as a precondition of competing in that area. Subsection 253(f) reads in part:

It shall not be a violation of this section for a state to require a telecommunications carrier that seeks to provide telephone exchange service or exchange access in a service area served by a rural telephone company to meet the

requirements in section 214(e)(1) for designation as an eligible telecommunications carrier for that area before being permitted to provide such service. This subsection shall not apply--

- (1) to a service area served by a rural telephone company that has obtained an exemption, suspension, or modification of section 251 (c)(4) that effectively prevents a competitor from meeting the requirements of section 214(e)(1); and
- (2) to a provider of commercial mobile services.

(Emphasis added.) The two exceptions to the discretion granted to the States do not include competitive neutrality, opening of all markets to competition, or minimization of regulatory involvement. Clearly, these goals must be subordinate to the goal of universal service if the requirement of consistency with the Act is to be met.

Accordingly, the cost support systems that are essential to the preservation of universal service, including the preservation of equity between urban and rural rates, should not be made unworkable or unreliable even to optimize the prospects for local competition. Indeed, it may be necessary to adopt two sets of approaches to universal service, one for rural telephone companies and one for all other telephone companies. Such an approach would match the approach used by Congress which recognized without hesitation the distinction between areas served by rural telephone companies and other areas.

The balance of these comments will address some of the individual significant policy issues that are raised by the NPRM.

II. SPECIFIC QUESTIONS TO BE ADDRESSED.

1. Selection of an Appropriate Basis for Determining Comparability of Rates Is Critical.

The Act establishes a standard of equity between urban and rural ratepayers, requiring that the services be available to high cost areas “at rates that are reasonably comparable to rates charged for similar services in urban areas” and that rates be “affordable.” Clearly, the concept of affordability requires that the total cost to customers of the basket of included telecommunications services be considered.

The question then becomes what services to include in the measurement and whether to include all services used by customers in the quantities actually used or whether to artificially limit the comparison to services that may be similarly described but are not similar in fact. The approach must surely be **to include all services in the category of protected services and to include the quantities of those services that customers actually** use to satisfy their telephone needs.

These principles lead to a feasible approach to the determination of comparability of rates that is also equitable and consistent with the intent of the Act. To be equitable, all services used by customers included in the basket of services subject to universal service protection should be included in the measurement. These would include the combination of charges included in the Universal Service Fund Data Collection conducted by the Commission in 1995 (the “USF Data Collection”) and identified in Section C, Subscriber Information, Lines 62 --67 and 133 -- 136 including without limitation local flat rate and measured service, extended area services, subscriber line charges, and interexchange services within the scope of Subsection 254(g) that

are used on a routine basis. In short, the measurement should be based on the average total telephone bills paid by customers for the basket of services that are within the scope to the services that Congress sought to protect.

Such an approach is fair to customers and recognizes the widely varied services that may actually be included in services that have the same general description. For instance, the Minneapolis/ St. Paul Metropolitan Area has one of the largest toll free calling areas in the nation, providing flat rated calling availability to almost 1,500, 000 local lines. That service is called R-1 service for residential customers and B-1 service for business single line customers. For many Rural Telephone Companies, including most Minnesota Independent Coalition members, toll free access is provided to less than 1,500 access lines. That service is also called R-1 service for residential customers and B-1 service for Business customers. From the perspective of the customers, the services provided in the Minneapolis/ St. Paul Metro area and in rural exchanges are hardly the same, since the Metro Area service includes toll free calling to 1,000 lines for each 1 line included in the small rural telephone companies' service areas.

It is also true, of course, that customers in the Metro Area actually call far fewer than the 1,500,000 lines available. They use some combination of local and interexchange services to meet their actual calling needs. Customers in small exchanges also use some combination of local and interexchange services to meet their needs. The proper way to achieve equity between such groups is to compare the average total monthly bills for these customer groups, including the actual use of all services in the category of services in the universal service basket. Appropriate data to begin such a comparison is contained in the Subscriber Information section, Lines 60 -- 249 of the USF Data Collection. The significant effort involved in obtaining this data

is justified given the importance of the Congressional goals of equity and affordability for customers.

It is quite probable that most customers in rural areas need to use far more short haul interexchange service than customers in large urban areas. To maintain the equity and affordability that Congress intended, it will be necessary that the rates for flat rate local service in rural areas be significantly lower than the flat rates for local service in urban areas, and that there be sufficient support to allow such lower local rates to be maintained not only for low income customers, but for all customers so that the goal of equity between urban and rural customers can be maintained.

2. Which Services Should Be Included in Universal Service Support?

The Commission also requested comments regarding which services to include for universal service support at the present time. NPRM ¶¶ 15 -- 23. At the present time, the services that should be included within the scope of financial support for end users include: single-party service with touch-tone capability, equal access to interLATA and intraLATA 1-- calling, access to directory assistance and operator services, directory listings, call trace services, emergency services number capability, national and state-wide telecommunications relay service for the hearing-impaired, and blocking of long-distance toll services.

These services are generally available at the present time. The prices for these services do not, however, alone provide an appropriate basis for measurement of cost recovery for providers of telecommunications services. Rather, the high cost of the infrastructure needed to

support those services provides the proper measure of financial support for providers of these services.

At this time, additional services beyond those set forth above need not be included in the basic set of essential telephone services since the concept of universal service relates to the maintenance of equity: 1) between urban and rural areas; and 2) between all subscribers, irrespective of income. The services listed above accomplish this objective of equity between both areas and customers.

While this list is appropriate at the present time, such a listing of services should not remain unchanged. As stated in Subsection 254(c):

Universal service is an evolving level of telecommunications services that the Commission shall establish periodically under this section taking into account...the extent to which such telecommunications services--

- (A) are essential to education, public health, or public safety
- (B) have, through the operation of market choices, been
subscribed to by a substantial majority of residential customers,
* * *
- (D) are consistent with the public interest, convenience, and
necessity.

While this is the test for future services, it also provides useful guidance for the initial list of universal services and supports the services set forth above.

3. The Method Selected to Determine the Levels of Support Must Be Reliable And Allow Fulfillment of the Essential Goals of Preserving Universal Service.

The Commission has requested comments regarding whether costs or prices should be used to determine the levels of support. NPRM ¶24. While relative prices paid by customers are an essential consideration, the level of support needed to achieve affordable prices must be set

with respect to the costs incurred to provide the service. Recovery of actual costs incurred to provide universal service must be accomplished to achieve Congress' fundamental goals for universal service, at least until the facilities represented by those embedded costs are no longer used to provide universal service. Such an approach is required both to provide equitable treatment of ratepayers, consistent with the intent of the Act, and to avoid serious issues regarding uncompensated confiscation for incumbent providers.

A. The CBG Model Is Completely Inappropriate For Rural Telephone Companies.

The NPRM specifically requests comments on the Census Block Group ("CBG") Benchmark Cost Model ("CBG Model"). While the scope and complexity of the CBG Model preclude full evaluation in the time available, a few characteristics are obvious and merit initial comment

1) The Assumptions of the CBG Model Are Unrealistic.

The CBG Model attempts to establish the theoretical costs of a newly engineered and constructed network, and does not attempt to determine the embedded costs of the existing network. Specifically, it assumes:

- A complete rebuild of the local network at the current time using lowest cost technology;
- Service of all CBG areas from the closest central office, instead of from the central office of the exchange in which the CBG area is actually located;
- The use of the ARMIS average cost characteristics drawn from all exchanges of largest LECs (the RBOCs), rather than the cost characteristics of the rural telephone companies that serve

a large portion of the highest cost areas (which are the areas requiring Universal Service support).

These assumptions of the CBG Model are systematically unrealistic and far more favorable than the conditions that actually apply to the existing network that will certainly be used for some time to provide universal service to most high cost areas.

In effect, the CBG Model starts from the assumption of use of construction of a new network using current, lowest cost technology. In contrast, the incumbent LECs, when faced with prior universal service obligations, have been required to provide services with **technology then available to customers as they need service**. In other words, contrary to the assumptions of the CBG Model, the incumbent LECs have been required to incur substantial embedded costs to fulfill prior universal service obligations. These facilities cannot be retired without major dislocations to customers. Since the embedded facilities will, in fact, be the facilities used to provide universal service in most high cost areas for a significant period of time, it is unrealistic and contrary to the Congressional intent of equity and affordability for ratepayers to base the costs on a model which is unrelated to the actual cost of providing service.

Another factor contributing to the potential underestimation of costs is the assumption that all CBG areas will be served from the closest central office. In contrast, in many instances, the central office actually used to provide service to a given CBG area will not be the closest central office. While it may be correct to assume the closest central office for most CBG areas, it is likely to become **an increasingly incorrect assumption as the distance from a rural CBG area to the city center increases**. This is a particularly significant problem, since it is the most

rural and highest cost areas that are the intended focus of the CBG Model. At a minimum, the CBG Model should be adjusted to reflect service from the actual serving central offices.

In addition, the cost factors that were applied to the theoretical network were based on the ARMIS cost characteristics of the RBOCs, not on the cost characteristics of the small rural telephone companies that serve so many high cost areas. In contrast, the current system is based on the actual costs of a representative sample of the same types of companies, serving the same types of areas that are the focus of the universal service effort. The assumptions underlying the current model are a far better fit to reality and to the intent of Congress that ratepayers be treated equitably and that rates actually be affordable to average ratepayers. The use of actual cost also better reflects the fact that many high cost areas that are served by small rural telephone companies are areas that large LECs did not wish to serve.

The cumulative effect of these assumptions is that the CBG model will inevitably misstate the costs of service, particularly as compared to the embedded costs facing the incumbent LEC.

Finally, the relationship between the current level of Universal Service and the recovery of the actual costs of service should not be overlooked. The current system of Universal Service support recovery is based on the actual reported costs of service of the LECs and has been very successful. To the extent that the CBG Model is intended to establish a significantly different level of cost supports, there is no reason to assume that there will not be significant long-run negative effects on the level of Universal Service achieved. Further, even if the use of a new model might not lead to an actual loss of subscribers, the equally important goal of preservation

of comparable rates between urban and rural areas will necessarily suffer if cost support is significantly reduced.

Accordingly, whatever decision is reached for large companies, the application of the theoretical, benchmark approach to small rural telephone companies would not be consistent with the intent of Congress.

2) The Scope of the CBG Model Raises Significant Concerns Regarding its Reliability.

In addition, the massive **scope** of the CBG Model raises significant questions regarding its reliability and virtually precludes any meaningful audit or review by many parties. Even the operation of the CBG Model requires computing capacity that is generally not available. The massive scope also assures that there will be many instances in which the CBG Model will lead to either understatement or overstatement of the actual costs of serving a particular CBG area. Since the effect of the CBG model on individual LECs is unknown and the impact on universal service of any significant reduction in the level of universal service support is also unknown, it would be far less risky and far preferable to refine the current cost models than to substitute a unknown model with so many clear risks to areas served by rural telephone companies that serve a high proportion of high cost areas that were not attractive to large LECs.

3) The Inherent Risks of Error in the CBG Model are Far More Severe for a Small Rural Telephone Company.

Given the combination of very broad scope and the broad and incorrect assumptions that underlie the CBG Model, it is inevitable that the costs of many areas will be overstated and the costs of many other areas will be understated as compared to the costs of a new network, to say nothing of the costs of the embedded network.

The risks of overstatement and understatement of costs may be acceptable in the context of achieving a nationwide estimate of costs of a newly engineered network or in the context of estimating the total average costs of a very large LEC, which will have a very large number of CBG areas within its serving area. In each of these contexts, overestimates of costs and underestimates of costs should tend to offset.

The risks of an inaccurate result are greatly magnified for a small rural LEC, however, which may have **very few** CBG areas in its service area and which may have a **very high percentage of very high cost** areas. In other words, while the averaging of both overstatements and understatements of costs may protect a large LEC which has the many CBG areas within its serving area, a small rural LEC cannot rely on averaging to minimize these errors because of the small number of CBG areas that it will serve.

Accordingly, the risk of error posed by a theoretical model, such as the CBG Model, is greatly enhanced for rural telephone companies as compared to the very large LECs, some of which have sponsored and support the CBG Model.

Second, as a practical matter, the incumbent rural telephone companies are required to operate with actual, embedded costs and do not have the option to enter or not enter a market based upon current technology and a theoretical cost support level. The incumbent LEC will presumably remain obligated to provide service to the areas for which the CBG Model has understated the actual costs. As such, the risk of significant underrecovery of actual costs is very severe for a rural telephone company that relies on Universal Service support to provide affordable local rates.

Such a systematic bias against the incumbent LECs is particularly troublesome for rural telephone companies (and their remaining customers) which may have a very small number of

CBGs to which they provide service. Here, errors will have a disproportionate impact of leaving high cost CBG areas with few options. Under this situation, any policy advantage of introducing competition in high cost areas is outweighed by the loss of network efficiency and the risks to other subscribers of such a result.

To partially address these problems, it is essential that any reliance on a theoretical cost model include an **opportunity** for an incumbent rural telephone company, in whose service area Universal Service support payments are to be provided, **to challenge the results of the CBG Model using actual cost data**, which can be reviewed for reasonableness, as necessary. If the actual, prudent costs to provide service are higher than the CBG Model results, the incumbent rural telephone company should be allowed to recover the actual costs of providing service.

B. Emphasis on Encouragement of Multiple Universal Service Providers, Including Bidding for Universal Service Support Levels, Compounds the Risk of Error for Areas Served by Rural Telephone Companies.

The Commission has requested comments in regards to several topics which relate to the encouragement of multiple universal service providers. NPRM ¶¶ 28, 30, 32, 33, 45. The Commission has also noted its intent to implement the Universal Service support mechanisms on a manner that “accords with our policy of competitive and technological neutrality.” NPRM ¶ 33.

While the different statutory standards for multiple eligible telecommunications carriers in the context of areas served by rural telephone companies and other areas are recognized (NPRM ¶ 42), the Commission also requests comments regarding the continuation of support for small telephone companies, including both the use of Part 36 costs and D.E.M.

weighting, and the impact on other possible universal service providers. NPRM ¶¶ 28, 29, 30. The Commission questions whether the continued use of “jurisdictional separations rules to subsidize LECs with above-average loop costs, or the local switching costs of small LECs, is consistent with Congress intent ‘to provide for a pro-competitive, de-regulatory national policy framework ...’ ” NPRM ¶ 30. The premises that appears to underlie these requests seems to be inconsistent with the Congressional priority for the preservation of universal service over competition in areas served by rural telephone companies.

As previously discussed, it is clear that Congress intended that preservation of universal service take priority over the promotion of competition, at least where these two policy goals may conflict in areas served by rural telephone companies. See, discussion of Sections 102(a), adding new Subsection 214(e)(2) and Section 253(f) at pages 4 - 6 above. Accordingly, it is essential that only **a single, facilities-based carrier receive universal service funding for areas served by rural telephone companies, unless a State commission determines that more than one recipient is appropriate. Such an approach is mandated by Subsection 102(a) of the Act, adding new Subsection 214(e)(2).** Nothing in the new universal service support mechanisms should be inconsistent with this priority.

The Commission has also requested comment regarding the use of bidding to set Universal Service support levels. NPRM ¶ 35. The use of bidding for universal service support levels will have the same adverse effect as other multiple provider approaches and is without support in the Act for areas served by rural telephone companies. Indeed, there is no discussion of bidding in the Act, except in the context of application of funds from the auction of spectrum to the Telecommunication Development Fund. Section 707.

Both the use of Universal Service support payments to multiple providers and bidding for Universal Service support payments to particular areas will **enhance the risk of errors** that is inherent in the theoretical CBG Model. As previously noted, it is inevitable that a theoretical model will produce erroneous estimates of both the costs of a new network and the actual embedded costs of the existing network. The costs of serving some areas will be overstated and costs for some areas will be understated. The overstatement of costs for some areas will provide inappropriate incentives for competing providers to provide service to those areas (to receive a share of the overstated costs).

In contrast, there will also be areas where the theoretical cost is understated as compared to the actual cost to provide service. As a result, the incumbent LECs will receive an inadequate level of support (based on CBG Model theoretical costs that are lower than the actual cost of providing service). Here, there will be substantial incentives for new providers, who have choices, to avoid providing service, since the support received will be inadequate. Accordingly, the new support mechanisms for areas served by rural telephone companies should not be slanted in the direction of facilitating an approach that is very likely to lead to market distortions and injury to the goals of universal service.

C. Service Areas Should Be No Smaller Than Exchange Areas of Incumbent Rural LECs Even if Support is Determined on A Different Basis.

The Commission also requested comment regarding the appropriate size of support areas for areas served by rural telephone companies. NPRM ¶¶ 33, 34, 44. The Commission further states:

We solicit comments on how to define ‘study area’ in the way that best comports with the Congress’s expressed objective ‘to provide for a pro-competitive, de-regulatory national policy framework’ for the ‘rapid [] private sector deployment of advanced telecommunications and information technologies.’

NPRM ¶ 45. As discussed above, the first priority of Congress with respect to areas served by rural telephone companies was the preservation of universal service. Congress expressed this priority by allowing states to require competitors to become eligible providers for a rural telephone company's entire service area and by allowing the states to limit universal support recipients to a single company in areas served by rural telephone companies. Accordingly, the consideration of changing the size of support areas for areas served by rural telephone companies should not impair this Congressional priority.

The prospects of market distortion including "cherry picking" are greatly enhanced if competitors are allowed to selectively serve areas smaller than the current service areas of rural telephone companies. If this decision is made, however, it may be necessary to reduce the basic geographic area on which support levels are determined.

The use of any size areas for support and any availability of universal service support for more than one provider will, however, require very careful integration of *all* related policies, including resale pricing issues, to avoid serious injury to customers in high cost areas served by rural LECs. The use of the current local service areas and the recovery of actual costs provide the only practical method for determining and supporting the costs of providing local service in the foreseeable future.

Based on the foregoing, the universal service support mechanisms and policies to be adopted by the Joint Board and Commission for rural LECs should be directed to the priorities established by Congress for such areas. Those mechanisms and policies should not conflict with Congress' recognition and intent that:

- A single facilities based eligible carrier is likely to provide the best and least expensive universal service for rural areas;
- The areas designated for eligible carriers should correspond to the current local exchange service areas of the incumbent rural LECs;
- The incumbent rural LEC should be the initial eligible carrier;
- Rural LECs should have an opportunity to substitute actual, embedded costs for any theoretical costs that may be adopted, so long as such embedded costs are not found to be imprudent or unreasonable.

4. Resale Obligations and Pricing and Deaveraging Of Local Rates are Closely Related.

As a matter of public policy, the Rules should do the most possible to limit situations in which there may be economic pressure to deaverage local rates. However, to the extent that new competitors are allowed to define local service areas smaller than the current local service area of the incumbent rural telephone company, then the incumbent must be allowed to deaverage local rates by area to match the area of potential competition from a new carrier. Such an approach is not generally feasible for many rural LECs with contractual obligations to charge uniform rates (in existing REA, now RUS mortgages). As a result, establishment of serving areas for new competitors smaller than the service areas of rural telephone companies is inherently unfair and will lead to either rate deaveraging or the artificial loss of customers to competitors who can underprice averaged rates.

Implementation of a new universal service model does not justify broad scale deaveraging which is unfair and unreasonable, even to customers who will not be priced out of